Filed 1/22/19 Selective 901 Truman, LLC v. Goodrich & Hops Properties West CA2/3

NOT TO BE PUBLISHED IN THE OFFICIAL REPORTS

IN THE COURT OF APPEAL OF THE STATE OF CALIFORNIA

SECOND APPELLATE DISTRICT

DIVISION THREE

SELECTIVE 901 TRUMAN, LLC, Plaintiff and Appellant, v. GOODRICH & HOPS PROPERTIES WEST, Defendant and Respondent.	B285836 (Los Angeles County Super. Ct. No. SS026325)

APPEAL from a judgment of the Superior Court of Los Angeles County, Nancy L. Newman, Judge. Affirmed.

Greenberg Traurig, Eric V. Rowen and Scott D. Bertzyk for Plaintiff and Appellant.

Ablon, Lewis, Bass & Gale, Jerald E. Gale and Lawrence J. Poteet for Defendant and Respondent.

Plaintiff and appellant Selective 901 Truman, LLC (Selective) appeals a judgment confirming an arbitration award that determined the fair rental value of real property that Selective leases to defendant and respondent Goodrich & Hops Properties West (Goodrich).

We conclude the trial court properly rejected Selective's various theories as to why the award should be vacated, and that it properly confirmed the award.

FACTUAL AND PROCEDURAL BACKGROUND

This controversy arises out of a periodic rent revision or rent reset clause contained in a long-term commercial ground lease (the Lease) for the real property located at 901-1041 Truman Street in San Fernando, California. The Lease provides the fair rental value of the property may be redetermined every 10 years, and if the parties are unable to agree upon rental value, the matter is to be resolved through arbitration. (See fn. 1, *post*.)

In 1957, the then-owner of the property, Southern Pacific Company (Railroad), leased the then-vacant and unimproved land to San Fernando Realty Company pursuant to a 53-year ground lease containing extension options allowing a term of up to 99 years, to December 2057. In 1984, the ground lease was assigned to Goodrich, which has been the ground lessee ever since. The property is improved with a retail strip shopping center consisting of three multi-tenant buildings with an area exceeding 30,000 square feet, and about 107 parking spaces.

1. *Events leading up to the arbitration proceeding.*

In December 2014, Selective purchased the real property, subject to Goodrich's ground lease, for $3,425,000, which was $75,000 below the offering price, in an all-cash transaction. The following month, in January 2015, Selective notified Goodrich

that it intended to increase the monthly rent from $9,488 per month (rent last reset in 2000), to $26,000 per month, an increase of $16,512 per month, based on Selective's determination that "the land value for the leased premises is $5.2 million" and as such, under Paragraph 27 of the Lease, "[t]he associated fair rental value and thus monthly rental due effective March 1, 2015 shall be $26,000 . . . per month."[1]

Selective took the position that notwithstanding the purchase price of $3,425,000, which represented the value of the land encumbered by 43 years remaining on the ground lease,

---

[1] Paragraph 27 of the Lease states in relevant part: "At any time or times after ten (10) years from the effective date of this lease such rental may be revised by [Lessor] giving thirty (30) days' advance notice in writing to Lessee. *Fair rental value of the leased premises shall be determined without consideration being given to the effect in such values of the improvements of Lessee* and in accordance with approved appraisal practices. This land shall be valued at the time of such revision as determined by [Lessor] and Lessee, but rental thereon should not be less than the minimum rental rate hereinbefore set forth, nor more than six percent (6%) per annum of the then appraised value of the land. When so revised, such rental shall not be subject again to revision until ten (10) years from the effective date of each such revision.

"In the event [Lessor] and Lessee are unable to agree upon rental value, then upon request of either [Lessor] or Lessee, the matter shall be settled by arbitration in accordance with the rules of the American Arbitration Association, and judgment upon the award rendered by the arbitrator(s) may be entered in any court having jurisdiction thereof. The fees and expenses of arbitration shall be borne as the parties may agree prior to the arbitration, or in case of disagreement, shall be apportioned by the American Arbitration Association fairly and equitably." (Italics added.)

"land value is to be determined as 'unencumbered' " and that fair rental value must be determined in accordance with the " 'highest and best use' " of the land. Selective offered to accept a rental rate of $24,000 per month to settle the matter.

In response, Goodrich stated it was "troubled by the concept that an asset purchased on day one for a $3+ million dollars could then somehow, a mere ten days later, be valued at well over $5+ million dollars." Goodrich contended an arbitration would result in a rental value nowhere near the $24,000 per month that Selective had proposed, and offered to pay an increased rent of $13,500 per month.

2. *The arbitration proceeding and the award*.

The matter proceeded to arbitration over a four-day period in December 2015. Witnesses and experts were called to testify and to opine on the fair rental value of the premises for the next 10 years, retroactive to March 1, 2015.

The basic issue before the arbitrator was whether the valuation of the property must take into consideration the effect of encumbrances on the property, which was burdened by 43 years remaining on the ground lease. The arbitrator noted the Lease stated that the rent determination shall not take into consideration the value of *improvements* on the subject property. However, the Lease was silent as to whether *encumbrances* on the property were to be disregarded for the purpose of determining fair rental value.

The arbitrator determined that the term fair rental value, found in Paragraph 27 of the Lease, "has essentially the same definition as [f]air [m]arket [v]alue, both leading to assumptions that a buyer is knowledgeable and under no compulsion to buy (or lease), and a seller is otherwise willing to sell (or lease) under

no compulsion to do so." The arbitrator found the Lease was not ambiguous and that "the Subject Property must be appraised assuming encumbrances on the Subject Property." The arbitrator rejected the opinion of Michael Waldron, Selective's appraiser, who valued the property, unencumbered, at $5.5 million. The arbitrator found Selective's valuation was excessive because it had failed to account for the impact of the long term ground lease. The arbitrator stated "[t]he ground lease in this matter, at a minimum, places a burden on the property and lowers its value because all of the options for the Subject Property have been exercised, the Lease has a 43 year term remaining with all of the limitations contained in paragraph 3 [limitations on use of the property] and the remaining lease resettings."

The arbitrator also rejected Goodrich's two appraisals as too low. One of the appraisers, Todd Basmajian, valued the property at the $3,425,000 purchase price in 2014, with a 4.5 percent rate of return. The other appraiser for Goodrich, Dale Donerkiel, opined the value of the property was $1,387,000, with a 4 percent rate of return.

Instead, the arbitrator relied on the recent $3,425,000 sale price of the property as the best indicator of its value, and determined that a 6 percent rate of return was appropriate.

The use of the purchase price as the best indicator of the value of the property was supported by Goodrich's evidence that the December 2014 sale of the subject property was "the perfect comparable" sale and that "there's no better way of figuring out the value of the property than taking it to market." The evidence showed that the property had just been just sold in an all-cash transaction, it had been listed with Marcus & Millichap, a sophisticated brokerage firm that deals with such properties, the

property was on the market with extensive marketing brochures, it was exposed for a reasonable amount of time and received multiple offers, "anybody buying this site knew what they were getting[,] [t]hey were buying the land underneath the center," and there was nothing to show it was not an arm's length transaction.[2]

Thus, the arbitrator concluded: "The purchase price for the property was $3,425,000. The Subject Property is and was encumbered by the Lease, including the restrictions on what the land may be used for in Paragraph 3. The Fair Rental Value of the Subject Property is reduced as a result of the encumbrances on the Subject Property. *The best indication of the value for the Subject Property is the price paid for the Property by a knowledgeable buyer*[.] The Fair Market Value of the Subject Property is therefore found to be $3,425,000. The new rent is set at 6% of $3,425,000, being $205,000 per year, $17,125 per month, commencing March 1, 2015 and continuing until the next rent adjustment." (Italics added.)

3. *Trial court proceedings*.

On June 24, 2016, Selective filed a petition to vacate the award (Code Civ. Proc., § 1286.2),[3] contending the award was "untethered" from the evidence and from California law. Selective argued that although the Lease called for fair rental

---

[2] Selective, in turn, contended the purchase price of the property was little better than a "fire sale" because the seller, who lived in Hawaii, had already sold all his other properties on the mainland, Goodrich, the tenant, "was a pain to deal with, and [the seller] didn't mind leaving money on the table."

[3] All unspecified statutory references are to the Code of Civil Procedure.

value to be determined by appraisals, the arbitrator rejected both sides' appraisals "and simply determined to use an improper method (the recent purchase price) as a surrogate for what the contract actually required." Selective asserted: "To allow an arbitrator to avoid vacatur by going through the pretense of 'admitting' evidence and then rejecting everything presented by both sides–in favor of [a] rationale not disclosed until the arbitration was over and that makes no effort to deliver what the arbitration agreement requires (an appraised fair market value of land based on accepted appraisal principles)–would be to neuter the 'safety valves' built into the Arbitration Act and 'undermine[] the fundamental principle embodied in section 1286.2, subdivision (a)(5) that an arbitrator must consider material evidence.' [Citation.] The Award should be vacated and the Court should order a new arbitration before a new arbitrator."

Goodrich filed an opposition to Selective's petition to vacate the award, as well as a counter-petition to confirm the award. Goodrich contended that Selective's petition had failed to show that the arbitrator refused to admit or consider material evidence, that Selective was denied a fair hearing on the merits, or that any of the statutory grounds for vacating an award were present.

After hearing the matter, the trial court entered an order denying Selective's petition to vacate the award, granting Goodrich's request to confirm the award, and directing entry of judgment in conformity with the award. Noting that a decision exceeds the arbitrator's powers " 'only if it is so utterly irrational that it amounts to an arbitrary remaking of the contract between the parties' " (*Advanced Micro Devices, Inc. v. Intel Corp.* (1994) 9

Cal.4th 362, 377), the trial court ruled that Selective had "not shown that the arbitrator's award arbitrarily remade the Lease Agreement. [Citations.] [¶] Rather the arbitrator's award appears to follow the arbitrator's interpretation of the lease agreement. The court has not found that the arbitrator has exceeded his scope of authority in making this award."

Selective filed a timely notice of appeal from the judgment.

CONTENTIONS

Selective contends: the arbitrator exceeded his authority (§ 1286.2, subd. (a)(4)); the arbitrator failed to hear material evidence (§ 1286.2, subd. (a)(5)); Selective was denied a fair and impartial hearing to its substantial prejudice (§ 1286.2, subd. (a)(3)); and if left undisturbed, the award will yield absurd results for the next 40 years—the duration of the Lease.

DISCUSSION

1. *General principles.*

a. *Limited statutory grounds for vacating an arbitration award.*

At the outset, we note that "[t]he scope of judicial review of arbitration awards is extremely narrow because of the strong public policy in favor of arbitration and according finality to arbitration awards. (*Moncharsh v. Heily & Blase* (1992) 3 Cal.4th 1, 32 (*Moncharsh*); *Cotchett, Pitre & McCarthy v. Universal Paragon Corp.* (2010) 187 Cal.App.4th 1405, 1416 (*Cotchett*).) An arbitrator's decision generally is not reviewable for errors of fact or law. (*Moncharsh*, *supra*, 3 Cal.4th at p. 6; *City of Palo Alto v. Service Employees Internat. Union* (1999) 77 Cal.App.4th 327, 333 (*Palo Alto*).) However, Code of Civil Procedure section 1286.2 provides limited exceptions to this

general rule[.]" (*Ahdout v. Hekmatjah* (2013) 213 Cal.App.4th 21, 33.)

As relevant here, an award may be vacated on the following grounds set forth in section 1286.2, subdivision (a): "(3) The rights of the party were substantially prejudiced by misconduct of a neutral arbitrator. [¶] (4) The arbitrators exceeded their powers and the award cannot be corrected without affecting the merits of the decision upon the controversy submitted. [¶] (5) The rights of the party were substantially prejudiced by . . . the refusal of the arbitrators to hear evidence material to the controversy[.]"

b. *Standard of appellate review*.

On appeal from an order denying a motion to vacate an arbitration award, we review the trial court's order (not the arbitration award) under a de novo standard. (*Malek v. Blue Cross of California* (2004) 121 Cal.App.4th 44, 55; *Haworth v. Superior Court* (2010) 50 Cal.4th 372, 383 [de novo standard applies to claim that arbitrator exceeded his or her powers].)

2. *No merit to Selective's claim that the arbitrator exceeded his authority by considering the impact of the long term ground lease in determining the fair rental value of the property.*

Selective's initial argument is that the trial court should have vacated the award because the arbitrator exceeded his authority. (§ 1286.2, subd. (a)(4).) Generally, a decision exceeds the arbitrator's powers " 'only if it is so utterly irrational that it amounts to an arbitrary remaking of the contract between the parties.' " (*Advanced Micro Devices, Inc. v. Intel Corp*., *supra*, 9 Cal.4th at p. 377.) Selective asserts the arbitrator exceeded his authority because the Lease "articulated a single and specific methodology for any arbitrator to apply in resetting rent: 'Fair

rental value of the leased premises shall be determined *without consideration being given to the effect in such values of the improvements of Lessee* and in accordance with approved appraisal practices.' The arbitrator simply had no authority to do anything differently." (Italics added.)

According to Selective, because the Lease specified that the arbitrator was required to ignore the value of the Lessee's improvements, the arbitrator was compelled to ignore the encumbrances on the property and was obligated to treat the land as unencumbered and "free for exploitation at its highest and best use."

There is no merit to Selective's claim that the arbitrator's interpretation of the Lease amounted to an arbitrary remaking of the contract. In view of the plain language of the Lease, the arbitrator did not remake the contract by taking into consideration the impact of the ground lease encumbrance in determining the property's value. We note that in addition to providing that the fair rental value of the leased premises was to be determined without consideration being given to the value of Lessee's improvements, Paragraph 27 of the Lease also provided that fair rental value shall be determined "*in accordance with approved appraisal practices*." (Italics added.)

As stated in the award, the arbitrator was mindful that "The Uniform Standards of Professional Practice . . . require[] the appraiser to do an analysis [of] the effect on value of the terms and conditions of the Lease." Further, the arbitrator noted "there is nothing in the Lease that states that the Lease and the provisions in the Lease related to options, resettings and the

limitations on use that exist under paragraph 3,[4] are not encumbrances, to be reviewed and analyzed by an appraiser. Therefore, the arbitrator finds the lease is not ambiguous and that the Subject Property must be appraised assuming encumbrances on the Subject Property."

In sum, the Lease required the arbitrator to comply with approved appraisal practices, and the arbitrator determined those practices require the land to be valued as encumbered by the ground lease rather than unencumbered. In reaching that conclusion, the arbitrator did not remake the contract between the parties and thus did not exceed his authority.

Harshad & Nasir Corp. v. Global Sign Systems, Inc. (2017) 14 Cal.App.5th 523, on which Selective primarily relies for its argument that the arbitrator exceeded his authority by considering the impact of the ground lease, is completely inapposite. There, the arbitrator exceeded his authority by deciding a claim for lost profits that a party had not agreed to arbitrate. (*Id.* at pp. 526, 542–546.) Here, the arbitrator did not decide an issue that the parties had not agreed to arbitrate. To the contrary, the arbitrator decided the key issue that the parties had tendered to the arbitrator, namely, whether the land was to be valued as encumbered by the ground lease or as unencumbered.

---

[4] Paragraph 3 of the Lease, relating to limitations on the use of the property, states: "Said premises shall be used by Lessee solely and exclusively for erection, maintenance and operation of office buildings, buildings for general commercial and manufacturing uses, parking lots which shall include a subterranean parking lot if deemed necessary, and heliport roof deck. [¶] Lessee agrees to comply with all applicable laws and regulations with respect to the use of the leased premises."

Selective also argues that the arbitrator exceeded his authority in considering the value of the encumbrances because in prior arbitrations, Goodrich tendered appraisals of the fair market value of the property as unencumbered, and the arbitrator should have found that Goodrich was bound by those prior admissions. The argument is meritless. In considering the impact of the ground lease encumbrance, the arbitrator was guided by the language of the Lease as well as the evidence of valuation that was presented in the instant arbitration proceeding. Accordingly, the arbitrator acted within the scope of his authority in taking into consideration the impact of the long term ground lease.[5]

---

[5] In the factual and procedural summary of its opening brief, Selective asserts that the arbitrator erred under California law in failing to value the land as if unencumbered by the leasehold. We note "an error of law apparent on the face of the award that causes substantial injustice does not provide grounds for judicial review." (*Moncharsh*, *supra*, 3 Cal.4th at p. 33.) Nonetheless, the arbitrator did not err in considering the impact of the encumbrance. In this regard, Miller & Starr states: "**Adjustment of ground rent**. In some cases, rent is determined by a percentage of the fair market value of the land periodically during the term of the lease, according to an appraisal of the property's fair market value. This is most common in long-term ground leases. [¶] A rental adjustment based on the market value of the land requires a determination of the price that would be paid by a willing buyer and acceptable to a willing seller and not the use value or rental value of the property. When the rent is based on the fair market value of the property, the appraiser must consider its value at its highest and best use, as if it were not encumbered with a lease with consideration of any restrictions on the use that would affect the price to be paid by a knowledgeable buyer. [¶] *By contrast, some*

3. *No merit to Selective's claim that the arbitrator failed to hear material evidence.*

Next, Selective contends the trial court should have vacated the award pursuant to section 1286.2, subdivision (a)(5), which provides for vacating the award where "[t]he rights of the party were substantially prejudiced . . . by the refusal of the arbitrators to hear evidence material to the controversy[.]"

Selective asserts vacatur is required pursuant to *Burlage v. Superior Court* (2009) 178 Cal.App.4th 524. In *Burlage*, an award was vacated because the arbitrator excluded evidence that was material to the controversy. (*Id.* at pp. 529–530.) Selective asserts *Burlage* is dispositive, stating "whether the Arbitrator erroneously excluded evidence up front (and thus it never had an opportunity to be 'heard' as part of the case) or whether he deliberately went through the pretense of admitting everything in hopes of avoiding vacatur but then rejected everything (i.e., chose not to 'listen'), the result is precisely the same: the parties have been left with a decision that is untethered from the evidence and California law the arbitrator should have considered – all to their substantial prejudice."

---

leases provide for adjustment based on the fair rental value of the leased premises, which would require consideration of the current use of the property." (10 Miller & Starr, Cal. Real Estate (4th ed.) Landlord & Tenant, § 34:74, fns. omitted, italics added.) Here, Paragraph 27 of the Lease provides for a determination of the "[*f*]*air rental value of the leased premises*" (italics added), *not* a determination of the fair market value of the *land*. Therefore, the arbitrator properly rejected Selective's position that the land must be valued at its highest and best use, unencumbered by the ground lease.

Selective's attempt to equate the instant case with *Burlage* is meritless. There, the arbitrator excluded material evidence and in doing so, substantially prejudiced one of the parties. Here, Selective does not identify any evidence that was excluded by the arbitrator—to the contrary, Selective acknowledges that the arbitrator admitted "everything" that was proffered. Selective's real argument is that after hearing all the evidence, the arbitrator rejected Selective's approach to valuation. However, the arbitrator's refusal to adopt Selective's theory of valuation does not constitute a failure to hear evidence material to the controversy within the meaning of section 1286.2, subdivision (a)(5).

4. *No merit to Selective's claim that it was denied a fair and impartial hearing to its substantial prejudice.*

Next, Selective contends it was denied a fair and impartial hearing to its substantial prejudice, requiring the award to be vacated pursuant to section 1286.2, subdivision (a)(3), which provides for vacation of an award where the "rights of the party were substantially prejudiced by misconduct of a neutral arbitrator." Selective argues "there was no inkling the Arbitrator would abdicate his mission to deliver an appraised value based on accepted appraisal principles, as required by the Lease. Indeed, the Arbitrator: (i) unabashedly refused to provide clarity as to the framework to be applied; (ii) rejected both sides' offerings in favor of an approach he did not articulate until the arbitration was over, and (iii) then, offered a non-appraisal rationale that cannot be squared with either the evidence or the contract."

Selective relies primarily on *Pacific Crown Distributors v. Brotherhood of Teamsters* (1986) 183 Cal.App.3d 1138 (*Pacific*

Crown). There, the appellant, the party that prevailed at the arbitration hearing, stated just prior to the end of the hearing that no other evidence would be submitted. (*Id*. at p. 1148.) Thereafter, the appellant raised a new issue in a posthearing brief. (*Id*. at p. 1146.) The trial court vacated the award and the reviewing court affirmed, stating that "[w]hile an arbitrator may have great discretion in evidentiary matters, it cannot be so broad as to deny a party a chance to challenge the introduction of a new issue at a confrontational, adversarial hearing as opposed to a challenge made through a post-hearing brief." (*Id*. at p. 1149.)

Pacific Crown is inapposite because it involves the predecessor to section 1286.2, subdivision (a)(1) [award procured by corruption, fraud or other undue means], not subdivision (a)(3) [rights of a party were substantially prejudiced by misconduct of a neutral arbitrator], which is the ground being asserted by Selective.

Nonetheless, relying on *Pacific Crown*, Selective complains that after the arbitrator directed *each party* to submit a closing brief, limited to 25 pages, Goodrich filed an additional 18 pages of supplemental charts and briefing as well as 140 pages of exhibits, which the arbitrator accepted over Selective's objection. However, the fact that Goodrich's supplemental papers exceeded the page limit set by the arbitrator and included additional exhibits does not establish that Selective's due process rights were compromised. In contrast, in *Pacific Crown*, the appellant's belated raising of a new issue in its posthearing brief was shown to be prejudicial. (*Pacific Crown*, *supra*, 183 Cal.App.3d at pp. 1148–1149.)

Selective then goes on to argue that the arbitrator rejected both parties' valuations in favor of a "nonappraisal rationale that cannot be squared with either the evidence or the [Lease]." The argument is meritless because the arbitrator was not limited to choosing between the parties' respective valuations.

The parties understood that the arbitrator possessed broad discretion to determine fair rental value. At the arbitration hearing, Goodrich's attorney stated to the arbitrator: "The scope of your power as arbitrator in this matter . . . is not limited to simply accepting—it's not a baseball approach. It's not one or the other." The arbitrator agreed, stating "when you have values this far apart, there's absolutely no question that I'm [not] going to do a baseball arbitration."[6] Although Selective complains on appeal that the arbitrator rejected both sides' valuations, Selective has not shown that the arbitrator lacked discretion to render an award other than one proposed by a party.

In the end, the arbitrator agreed with Goodrich's stance at the hearing that the December 2014 sale of the subject property was "the perfect comparable" sale and that "there's no better way of figuring out the value of the property than taking it to market." It was the arbitrator's prerogative to rely on the recent sale of the property as the best indicator of its value, that approach had been raised at the hearing, and therefore Selective

---

[6] " 'Baseball' arbitration is a process by which each party submits a separate proposed award to the arbitrator after the arbitrator has heard the evidence. The arbitrator must then adopt one of the proposed awards as the arbitrator's final decision. The arbitrator does not have discretion to render an award other than one proposed by a party." (Gutterman, Lehrman & Schaffer, 2 Cal. Transactions Forms-Bus. Transactions, § 14:101.)

could not have been surprised by the arbitrator's ultimate decision.

For these reasons, there is no merit to Selective's contention that the trial court should have vacated the award on the ground the "rights of the party were substantially prejudiced by misconduct of a neutral arbitrator." (§ 1286.2, subd. (a)(3).)

5. *No merit to Selective's claim that the award will yield absurd results for the remainder of the lease term.*

Selective's final contention relates to the following provision in the arbitrator's award: "Future rent resettings shall be determined by appraisal of the Subject Property *as encumbered by the Lease terms*, including the remaining time on the Lease and any restrictions on use contained in the Lease or by conditions and restrictions imposed by the [C]ity of San Fernando." (Italics added.) Selective contends that due to the impact of the award on future rent resettings, if left undisturbed the award will yield absurd results, not just for the next 10 years, but for the next 40 years, for the remaining duration of the Lease. We note that this contention does not come within the framework of section 1286.2 and thus is not a basis for vacating the award.

Moreover, the argument is meritless because, as discussed, the arbitrator acted within his authority in determining the land should be valued as encumbered by the ground lease rather than unencumbered. Further, as the arbitrator observed, "[t]he land will become more valuable in the future and at every resetting. The encumbrance on the land will lessen due to the remaining years under the Lease." Stated another way, as the years pass and the burden of the ground lease encumbrance diminishes, the value of the land and therefore its fair rental value should

continue to climb. We do not perceive any absurdity in the arbitrator's reasoned analysis.

DISPOSITION

The judgment confirming the award is affirmed. Goodrich shall recover its costs on appeal.

NOT TO BE PUBLISHED IN THE OFFICIAL REPORTS

EDMON, P. J.

We concur:

LAVIN, J.

DHANIDINA, J.